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No. 525

IN THE

Supreme Court of the United States

OCTOBER TERM, 1964

IOWA SOUTHERN UTILITIES COMPANY, *Petitioner*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

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Petitioner prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Eight Circuit, entered in the above-entitled case on June 25, 1964 (Appendix p. 19a).

OPINIONS BELOW

The opinion of the Court of Appeals (Appendix pp. 1a-11a) is reported at 333 F. 2d 382. The memorandum opinion of the Tax Court (T.C. Memo. 1962-267; Appendix pp. 11a-18a) is not officially reported. It appears at 21 TCM 1427.

JURISDICTION

The judgment of the Court of Appeals was entered on June 25, 1964. The jurisdiction of this Court is invoked under Section 1254(1), Title 28, United States Code.

QUESTION PRESENTED

Whether in determining its 1955 Federal income tax liability the petitioner is entitled to deduct the legal fees and expenses incurred in a stockholders' suit to recover funds fraudulently taken by its officers when they were engaged in buying utility properties for the petitioner.

STATUTE INVOLVED

Internal Revenue Code of 1954, 26 U.S.C. 1958 ed.,

"§162. Trade or business expenses

"(a) In general.—There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. . ."

"§212. Expenses for production of income

"In the case of an individual, there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year—

"(1) for the production or collection of income;

"(2) for the management, conservation, or maintenance of property held for the production of income. . ."

"§263. Capital expenditures

"(a) General rule.—No deduction shall be allowed for—

"(1) Any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate."

STATEMENT

The facts were fully stipulated in the Tax Court (Appendix p. 12a) and may be summarized as follows:

The petitioner, a Delaware corporation with its principal place of business at Centerville, Iowa, is a public utility company engaged in the production and sale of electrical energy. In 1943, certain of petitioner's former preferred shareholders instituted a derivative action in an Iowa state court against George M. Bechtel (the former president, director and majority shareholder of petitioner) and others. The complaint in that action alleged that Bechtel, his son Harold, and other individual defendants had secretly acquired certain utility properties at prices far less than those at which they turned them in to the petitioner, and had wrongfully appropriated the illegal gains.

The trial court found that the frauds alleged had been committed but that the claims were barred by laches and the statute of limitations. In January, 1952, the Supreme Court of Iowa reversed the lower court and ordered the entry of judgment in favor of the petitioner herein in an amount in excess of $2,200,000. The details of the financial machinations whereby the petitioner's assets were systematically and fraudulently plundered by Bechtel and his subservient associates are set out in the opinion of the Supreme Court of Iowa in *Des Moines Bank & Trust Co., et al.* v. *George M. Bechtel & Co., et al.*, 243 Iowa 1007, 51 N.W. 2d 174 (1952), which facts were stipulated to be true in the instant proceeding. In 1953 and 1954, the petitioner herein collected approximately $487,000 on the judgment rendered in the derivative action.

The attorneys for the plaintiffs in the derivative action then applied to the Iowa court for the allowance of their fees and expenses. In June, 1955, the court entered judgment in favor of the attorneys and against the petitioner herein for $160,218.66, which amount was paid by petitioner in 1955.

In its Federal income tax return for 1955, the petitioner deducted that amount as an ordinary and necessary business expense under Section 162(a) of the 1954 Code. The Commissioner of Internal Revenue disallowed the deduction and determined a deficiency in petitioner's income tax liability for 1955. The Tax Court, in a memorandum opinion filed November 16, 1962 (T.C. Memo. 1962-267; Appendix pp. 11a-18a), upheld the Commissioner's determination, on the ground that the attorneys' fees and expenses were attributable to the recovery of capital, and entered judgment for a deficiency in the amount of $74,330.15. The Court of Appeals for the Eight Circuit upheld the judgment of the Tax Court in an opinion entered June 25, 1964 (Appendix pp. 1a-11a).

REASONS FOR GRANTING THE WRIT

1. The decision below is erroneous and in conflict with decisions of the Courts of Appeals for the Second, Fourth, Sixth and Tenth Circuits, the Court of Claims and the Tax Court: *Commissioner* v. *Speyer*, 77 F. 2d 824 (2d Cir. 1935), certiorari denied 296 U.S. 631; *Commissioner* v. *Ullmann*, 77 F. 2d 827 (2d Cir. 1935), certiorari denied 296 U.S. 631; *Alexander Sprunt & Son, Inc.* v. *Commissioner*, 64 F. 2d 424 (4th Cir. 1933); *Kales* v. *Commissioner*, 101 F. 2d 35 (6th Cir. 1939); *United States* v. *Pate*, 254 F. 2d 480 (10th Cir. 1958); *California and Hawaiian Sugar Refining Corp., Ltd.* v.

United States, 311 F. 2d 235 (C.Cls. 1962); *Ticket Office Equipment Co.* v. *Commissioner*, 20 T.C. 272, aff'd per curiam on another issue 213 F. 2d 318 (2d Cir. 1954); *Missouri-Kansas Pipeline Co.* v. *Commissioner*, issue 2, 3 TCM 15 (1944), aff'd on other issues 148 F. 2d 460 (3rd Cir. 1945).

In *United States* v. *Pate, supra*, legal fees and expenses incurred in recovering the value of taxpayer's building, destroyed by fire, were held to be fully deductible under Section 23(a)(1) of the 1939 Code [the predecessor of Section 162(a) of the 1954 Code]. The Court of Appeals for the 10th Circuit stated, at page 483:

> "* * * it is the well settled general rule that sums paid to an attorney for services rendered in litigation * * * *to recover assets for the trade or business of the taxpayer* * * * are deductible as ordinary and necessary expenses under Section 23(a)(1)."

In *Kales* v. *Commissioner, supra*, the Court of Appeals for the Sixth Circuit held that legal fees incurred to recover income taxes paid by the petitioner were deductible as ordinary and necessary business expenses.

In *California and Hawaiian Sugar Refining Corp., Ltd.* v. *United States, supra*, the Court of Claims held legal expenses incurred in securing a refund of processing and floor stock taxes paid by the plaintiff under the Agricultural Adjustment Act were deductible as ordinary and necessary business expenses under Section 23(a)(1) of the 1939 Code, even though the taxes recovered were held to be a return of capital.

In *Commissioner* v. *Speyer, supra*, the taxpayer recovered an award from the Mixed Claims Commission for the seizure of its bank accounts in Germany. The